FISCAL NOTE

Bill #:	SB0443	**Title:**	Income tax credit on capital gain from sale of income-producing property
Primary Sponsor:	Taylor, M	**Status:**	As Introduced

Sponsor signature Date   Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY 2004 Difference	FY 2005 Difference
Expenditures:		
General Fund	$0	$0
Revenue:		
General Fund	$0	$0
Net Impact on General Fund Balance:	$0	$0

- ☐ Significant Local Gov. Impact
- ☐ Included in the Executive Budget
- ☐ Dedicated Revenue Form Attached
- ☒ Technical Concerns
- ☒ Significant Long-Term Impacts
- ☐ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. This bill applies to tax years beginning after December 31, 2003 (tax year 2004).
2. Under this bill, taxpayers would be allowed a tax credit against individual income taxes in an amount equal to taxes paid by the individual on capital gains from the sale of a controlling interest in income-producing property.
3. The credit would be taken in seven equal installments beginning the tax year following the year in which the sale is reported and the tax on the sale is paid. Under this scenario, a taxpayer who sold assets eligible for the credit in tax year 2004 would report the sale and pay taxes on forms in tax year 2005. The tax credit would first be available the following year, for tax year 2006, and would show on a return filed after December 31, 2006 in fiscal 2007. Consequently, there is no revenue impact from this proposal in the 2005 biennium. Credits from the sale occurring in tax year 2004 would be used in fiscal years 2007 through fiscal year 2013.
4. The annual credit installment could not exceed the taxpayer's tax liability for any year allowed, and no portion of the annual allowable amount could be carried forward or backward to any other tax year.
5. The bill provides that for the purposes of determining the initial amount of tax paid on the capital gains that the taxpayer is presumed to have paid taxes on the qualifying sale amount at the top marginal rate in effect in the year in which the tax on the sale is reported and paid. Further, if the amount of the gain exceeds the amount of income subject to the top marginal rate, the rate for the balance of the gain is presumed to have been paid at the lesser rates in the appropriate declining rate brackets.

6. Eligibility for the credit requires that the property sold must be "income-producing property" located in Montana in which the taxpayer owned at least 50% at the time of sale, and that the taxpayer's involvement in the production of income from the property was not a "passive activity", as defined by federal statutes.
7. There are no administrative expense impacts from this bill for the Department of Revenue.

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
No impact.

LONG-RANGE IMPACTS:
1. This bill will not impact revenues to the general fund until fiscal year 2007. An accurate estimate is not possible in that year. However, the impact of this bill will grow significantly in every fiscal year following fiscal 2007 until the full annualized impact of the bill is reached first in fiscal 2013. This is because taxpayers are allowed a credit equal to *one-seventh* the tax paid on the gain in each year. In fiscal 2007 the impact will reflect approximately one-seventh the full annualized impact of the credit in any year; in fiscal 2008 the impact will reflect approximately two-sevenths the full impact, and so on. Not until fiscal 2013 will the full annualized impact (seven sevenths) be reached.
2. While it is not possible to determine a precise estimate of the revenue impact of this bill (see technical notes, below), it is possible to approximate the impact under certain assumptions. Under current law, completely eliminating the tax on capital gains is forecast to reduce tax liabilities by $47.9 million in tax year 2004; $54.3 million in tax year 2005; and $56.1 million in tax year 2006. If these impacts grow by 5% annually in tax year 2007 and thereafter, then the approximate impact of this bill in fiscal years 2007 through 2013 is shown in the following table.
3. The impact will depend on the share of total reported capital gains that will be eligible for the credit. The table provides impacts under alternative assumptions ranging from 90% to 50%. For example, in fiscal 2007 general fund revenues would be reduced an estimated $3.4 million if 50% of the gains are eligible for the credit, and an estimated $6.2 million if 90% of the gains are eligible for the credit. By fiscal 2013, general fund revenues would be reduced an estimated $29.5 million if 50% of the gains are eligible for the credit, and an estimated $53 million if 90% of the gains are eligible for the credit.

Decrease in General Fund Revenue Under SB443

Share of Capital Gains Eligible for Credit	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013
90%	(6,161,044)	(13,136,077)	(20,352,709)	(27,930,172)	(35,886,508)	(44,240,661)	(53,012,522)
80%	(5,476,483)	(11,676,513)	(18,091,297)	(24,826,820)	(31,899,118)	(39,325,032)	(47,122,242)
70%	(4,791,923)	(10,216,949)	(15,829,885)	(21,723,467)	(27,911,729)	(34,409,403)	(41,231,961)
60%	(4,107,363)	(8,757,385)	(13,568,473)	(18,620,115)	(23,924,339)	(29,493,774)	(35,341,681)
50%	(3,422,802)	(7,297,821)	(11,307,061)	(15,516,762)	(19,936,949)	(24,578,145)	(29,451,401)

TECHNICAL NOTES:
1. The impacts of this bill will depend on several critical factors not well defined in the bill. Specifically, the credit is allowed only on those gains from the sale of a "controlling interest" in "income-producing property". Neither of these terms is defined with enough specificity to determine which gains would be eligible for the credit. (For example, are stocks that pay dividends income-producing property?)
2. The bill provides that the taxpayer is presumed to have paid taxes on the qualifying sale amount at the top marginal rate in existence at the time the sale is reported. If the amount of the gain exceeds the amount of income subject to the top marginal rate, the rate for the balance of the gain is presumed to have been paid at the lesser rates in the appropriate declining rate brackets. But the bill is not specific as to how these rates are to be applied.